Continuing leases and renewals

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Paul Clark seeks to clarify a number of problems confronted by SDLT practitioners

A lease may be granted for a fixed term (of any duration) then continue until brought to an end by notice to quit. Or a lease may have no initial fixed term, but run until it is brought to an end on notice – a periodic lease. An implied lease will usually be a periodic lease. The two are subject to different SDLT treatment.

All paragraphs referred to in this article are of schedule 17A of the Finance Act 2003.

There is either no guidance from HMRC on the issues raised, or it is out of date.

1. Periodic (paragraph 4)

A periodic lease is initially taxed as an indefinite term, so for 12 months. If the lease "grows" one day beyond 12 months, it is taxed as a 24-month lease, and so on, even if notice to quit has already been given to expire during the growth period. The whole tax, or extra tax, is due 29 days from the start of the growth period. When the lease ends, no SDLT can be reclaimed.

2. A fixed term that continues (paragraph 3)

A fixed term is initially taxed on that term, whether it is for a week or 99 years. If it continues one day beyond the fixed term it is then taxed for a term 12 months longer than the fixed term – and so on. But the extra SDLT is payable 30 days after the end of the growth period – or after the end of the lease if it expires, and only for the period to the end of the lease.

Both types of continuing lease were taxed similarly until 2013, when paragraph 3 was changed but not paragraph 4. It is now more tax-efficient for a tenant to take a short fixed-term lease that continues than to take a wholly periodic lease, and better for the tenant's cash-flow as well.

Stamp duty leases

If the continuing lease was originally subject to stamp duty it is not subject to SDLT on its continuation.

Continuation

When a lease ends, the tenant may stay in occupation. If the tenant is a trespasser, or a licensee or a tenant at will, no SDLT is payable. Sometimes a tenant will be able to claim an implied periodic tenancy, but if it does, SDLT will be payable on the new periodic lease under paragraph 4.

A lease term cannot be extended by agreement. Such a variation operates as an implied surrender and regrant (and if the old lease was subject to SDLT, overlap relief may be available). The only way a lease can legally continue is if it is granted as a continuing lease, or statute operates to continue it.

So a business lease that was originally subject to SDLT and is protected under the Landlord and Tenant Act 1954 will continue under the Act if the tenant remains in occupation. The tenant must pay extra SDLT under paragraph 3.

Lease renewal

Where a lease is renewed, rent is taxed on the same basis as any new lease, on the net present value of actual rents for the first five years of the term and of a notional rent (equal to the highest 12 consecutive months' rent in the first five years) for all

years after the fifth. The “first year of the term” for SDLT purposes cannot start before the date of the lease – with two exceptions. Both relate to renewal of an old lease that was itself subject to SDLT. Neither applies to renewal of a stamp duty lease.

Paragraph 9A

Where

- the tenant stays in occupation after the old lease expires, and
- the tenant is granted a new lease of the same or substantially the same premises, and
- the term of the new lease begins when the old lease expires,

then for SDLT purposes the term of the new lease starts on the backdated term commencement date, and ‘overlap relief’ prevents taxed rent from being taxed again.

Paragraph 9A can apply whether the tenant stays in possession because the lease is statutorily continued, or simply because the landlord permits occupation while the new lease is agreed.

Paragraph 3A

Where

- a fixed term lease “grows” by one or more 12-month periods during the last of which the tenant is granted a lease of the same or substantially the same premises and whose term commences in that same 12-month period, and
- paragraph 9A does not apply,

then the old lease does not continue during that last 12-month period.

Instead, for SDLT purposes

- the new lease term starts when that 12-month period starts, and
- SDLT will be charged on the old lease rent from that start date up to the date the new lease rent starts.

Paragraph 3A applies only where the old lease continues, so there would need to be a “fixed term lease continuing” or continuation by virtue of statute.

Substantially the same premises

Both paragraphs require the new lease to be of “the same or substantially the same premises”. HMRC have issued no guidance on what this phrase means, but it seems that so long as the new lease includes all, or substantially all, of the property comprised in the old lease, the new lease is likely to qualify, even if it includes other property as well.

A tenant can renew a business lease only on premises the tenant is occupying for the purposes of its business. So if a tenant renews a lease of just part of premises demised by the original lease, it is unlikely the new lease will qualify for treatment under either of these paragraphs as it will not be a lease of the same, or substantially the same, premises. Such a renewal lease is taxed as any new lease.

The actual term

The term commencement date of a renewal lease is frequently backdated. Most 1954 Act renewals are negotiated against the statutory background, with application to court as a last resort. The parties may agree term and rent commencement dates. Often the date is immediately after the old term ended (so paragraph 9A may apply where the premises are substantially the same). Where the old lease was terminated by a section 25 notice or a section 26 request, the new term and the new rent may be backdated to start immediately after the date stated in the notice or request.

Where a new lease is agreed, section 28 of the 1954 Act states that the old lease continues until the date the parties agree that the term of the new lease is to start. If there is a court order, the old lease terminates immediately before the new one commences (section 29(1) of the 1954 Act).

Applying the rules

Where paragraph 9A applies it is relatively easy to calculate SDLT, applying overlap relief by deducting from the rent taken into account when calculating NPV the rent

taxed for the continuation period (even though that tax may sometimes be payable after the date of the renewal lease).

The application of paragraph 3A is a little more tricky as can be seen by this example: Assume a 10-year lease ends 31 December 2014, and continues until 30 June 2016 when a renewal lease is granted for 5 years starting 1 July 2016 at £150,000 rent. Rent was originally £100,000, but after review had been £130,000.

For the continuation year 2015 we assume an 11-year lease at £100,000, deduct SDLT already paid, and the extra SDLT is due by 30 January 2016. Since the new lease is granted during 2016, its term is treated as starting 1 January 2016, ending 30 June 2021.

We calculate SDLT for the first year of that term on the NPV of £130,000 for six months and £150,000 for six months. (Note it is £130,000, not £100,000. Paragraph 3A refers to the "rent payable" under the old lease, not the rent already taxed.) For the remainder of the new lease term rent is £150,000 a year.

If paragraph 3A does not apply to the same set of facts (perhaps because the new lease is not of the same premises) tax is charged on the old lease for eleven and a half years, and (after deducting SDLT already paid) the extra is payable by 30 July 2016, whereas tax on the new lease is due by 31 July 2016.

The backdating problem

In *Bradshaw v Pawley* [1980] 1 EGLR 49 a tenant under a renewed lease agreed to pay rent "during the term", but the term commenced four years earlier, and rent was six times that paid under the old lease. Although a tenant is not normally liable for rent prior to the date of a lease, the lease itself may impose that liability, and the tenant's agreement to pay the increased rent "during the term" was enough here.

Section 55 (1A) of the Finance Act 2003 states that 'rent' does not include any chargeable consideration for the grant of a lease that is payable in respect of a period before the date of the lease (unless paragraphs 3A or 9A apply) so such consideration has to be taxed as a premium.

By way of illustration – assume that the lease dated 30 June 2016 is for a term of five years starting 1 January 2015 and that neither paragraph 3A nor 9A applies.

If the tenant has paid no rent since 1 January 2015, then £225,000 will be due as a lump sum on completion of the new lease, and be taxable as a premium. But if the tenant has been paying £130,000 under the old lease and pays a lump sum of £30,000 by way of increased rent on the grant of the new one, the tax due on that ‘premium’ will be at 0% as it is below £150,000. The rules changed on 1 April 2016; before then the payment would have been taxable at a minimum rate of 1% as the average annual rent exceeded £1,000. And if the tenant has been paying the new rent voluntarily prior to completion of the new lease, as sometimes happens, nothing extra will be due on completion – so there will be no chargeable consideration in respect of a period before the date of the lease.